

No. 11912

In the United States Circuit Court of Appeals
for the Ninth Circuit

THE DAVENPORT FOUNDATION, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

ON PETITION FOR REVIEW OF THE DECISION OF THE TAX
COURT OF THE UNITED STATES

BRIEF FOR THE RESPONDENT

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OPINION BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 28-43) are not reported.

JURISDICTION

This petition for review (R. 44-51) involves Federal income and declared value excess profits taxes for the calendar years 1940 through 1944. On March 1, 1946, the Commissioner of Internal Revenue mailed to the taxpayer notice of deficiencies in the total amount of \$10,047.83. (R. 7-21.) Within ninety days thereafter and on April 1, 1946, the taxpayer filed a petition with the Tax Court of the United States for a redetermination of that deficiency under the provisions of Section 272 of the Internal Revenue Code. (R. 4-

21.) An amended petition was filed on February 14, 1947. (R. 23-26.) The decision of the Tax Court sustaining the deficiencies was entered December 29, 1947. (R. 43.) The case is brought to this Court by a petition for review filed March 24, 1948 (R. 44-52), pursuant to the provisions of Section 1141 (a) of the Internal Revenue Code, as amended by Section 36 of the Act of June 25, 1948.

QUESTION PRESENTED

Whether or not the Foundation was exempt from taxation under Section 101 (6) or Section 101 (14) of the Internal Revenue Code for the years 1940 through 1944.

STATUTE AND REGULATIONS INVOLVED

The statute and regulations involved in this case are found in the Appendix, *infra*.

STATEMENT

The facts found* by the Tax Court (R. 28-37) may be summarized as follows:

The Taxpayer Foundation, hereinafter referred to as the Foundation, the principal office of which is in Pasadena, California (R. 28), was incorporated on July 8, 1940, under the laws of California as a non-profit corporation (R. 33). It is the successor to the Davenport Foundation, a trust (R. 29), hereinafter referred to as the trust, and was created to replace a college as trustee under a trust created by one Levi M. Davenport (R. 33). The stated purpose, in the Foun-

*Any reference to the evidence is made by specific record citation other than pp. 28-37.

dation's document of creation, was "To act as Trustee under Christian Educational, Charitable, Eleemosynary, and other charitable trusts" and its charter contains the usual powers and customary provisions found in corporate charters of this character. No provision was made for the distribution of income. (R. 33.)

On May 23, 1939, Levi M. Davenport executed an irrevocable transfer in trust of certain real and personal property to La Verne College as trustee and five persons, including Mrs. Lucile Davenport Weller, the trustor's daughter (R. 66), constituting a board of directors. On the date of the transfer the property had a value of \$261,884. On June 1, 1939, Barbara N. Davenport, the trustor's wife, transferred to the trust two parcels of real estate having a value of \$8,500. (R. 29.)

The trust indenture, under which the transfers were made to the trust, stated that the only duty or obligation of the trustee shall be to hold title to the property and perform such acts as shall be necessary to carry out the orders and directions of the board of directors. The board had complete control, management and operation of the property forming the trust estate and was to collect principal and income and after the payment of specified deductions, to pay, accumulate, use and invest, hold and distribute, funds for the purposes stated in the indenture. No specific purposes were stated but specifications were made under various headings in the indenture (R. 85-96), one of which headings was "Distribution of Income" (R. 29-30).

Under that heading it was provided in Section 1 that \$400 per month was to be paid to Levi M. Davenport, the trustor, for and during the term of his natural life and in Section 3 that suitable and proper provision was to be made for the support and maintenance of the trustor's brother, as his needs might require, not to exceed \$100 per month, and that the board of trustees, solely within its discretion, should use a portion of the income to care for any of the trustor's children as their needs might require, should any of them come to want. Section 5 provided for the payment of annuities to annuitants who added to the trust. In Sections 2 and 4, respectively, it was provided that \$300 per month was to be paid to La Verne College to establish a department of Philosophy and Religion and \$300 per annum to the American Bible Society. (R. 30-31.)

Under the heading "Reservations" the indenture provided that the trustor, Levi M. Davenport, during his lifetime, should have the right to the use and occupation, rent-free, of his residence property or some other home of similar rental value (R. 31-32), and no other specific reservation was made (R. 92).

The indenture provided further that the board of trustees might advise or consult with the trustor regarding the sale or retention of trust property and investment of the trust's funds, or the exercise of any of its powers, and that in following in whole or in part any of his requests or recommendations the board should be free of any responsibility for losses or liability to the trust estate. (R. 95-96.) It provided also

that the trust could not be revoked nor any of the corpus of the trust estate be withdrawn. (R. 96.)

Under "Powers of Trustees" (R. 93, 96), the indenture authorized the board of trustees, after the death of the trustor and the individual beneficiaries, to incorporate the trust "in which event La Verne College shall convey all of its title in the trust estate to such corporation upon request of the board" (R. 32).

Included in the real estate conveyed to the trust by Levi M. Davenport was a parcel known as the "First Street property". After the trust was created the trustor desired to improve that property and when the trustee was advised that it could not borrow money for the benefit of the trust the property was reconveyed to him to make the improvements and then to be reconveyed to the trust. Moreover, it was agreed that the Davenport home had been transferred to the trust by mistake and had not been intended to be a part of the trust at that time. It also was reconveyed to the trustor. (R. 32-33.) Both reconveyances were made despite the provision of the trust indenture that no part of the trust estate could be withdrawn. (R. 96.)

After the creation of the Foundation on July 8, 1940, the board of trustees of the trust adopted a resolution directing La Verne College to convey the trust property to the Foundation and this was done on October 8, 1940. The resolution provided that the conveyances and transfers should be made subject to the trust indenture of May 23, 1939, and that the acceptance of the property by the Foundation "shall be a recognition of the fact that the assets so trans-

ferred are subject to and accepted by this corporation, subject to the terms and provisions of said Declaration of Trust". (R. 33-34.)

On or about May 31, 1941, Levi M. Davenport and his wife transferred the "home place" to the Foundation and contemporaneously entered into an agreement with it under which (a) they retained the right to use the home place for their lives, and (b) the Foundation agreed to pay Lucile Davenport Weller an annuity of \$100 per month and upon her death to pay her daughter, Dorothy Mae Weller, an annuity of \$100 per month. The Foundation's obligation to pay these annuities was absolute and not dependent upon whether the Foundation had net income or net earnings. The annuity to Dorothy Mae Weller was to be reduced under certain conditions not material to this case. The value of the home place on the date of transfer was \$15,500 and its fair rental value was \$1,500 per annum. No rent was ever paid to the Foundation for its use but during the taxable years Mr. Davenport turned over to the Foundation \$432.25 which was part of the money he received from renting rooms in the Davenport home (R. 78), and the Foundation paid taxes and other expenses of upkeep on it, amounting in the years 1941 through 1944, to \$4,206.63. (R. 34.)

On or about May 31, 1941, Levi M. Davenport and his wife transferred the "First Street property" to the Foundation and contemporaneously entered into an agreement with it under which Levi M. Davenport reserved the net income from the property for his life and the right to designate, in writing, during his

lifetime the disposition of the net income for a period not to exceed ten years after his death. This designation was not made by Mr. Davenport. The value of the "First Street property" at May 31, 1941, was \$40,000, and its fair rental value was \$5,400 per annum. The Foundation never received any income from this property and while Mr. Davenport paid the taxes for the years 1940 through 1944, expenses of upkeep for those years, amounting to \$1,720.12, were paid by the Foundation. (R. 35.)

During the taxable year 1940, the Foundation paid Lucile Davenport Weller \$1,000 for the benefit of Levi M. Davenport in connection with his acquisition of certain shares of stock of L. M. Davenport Company, a separate corporation which was dissolved about the time the Foundation was organized (R. 66, 69), and in 1941 it paid Homer Davenport the amount of \$625 for the same reason. The stock held by Lucile Weller and Homer Davenport was surrendered to Levi M. Davenport. (R. 36.) In each of the taxable years 1941 through 1944 the Foundation paid Lucile Weller the amount of \$1,200 pursuant to the terms of the annuity agreement of May 31, 1941. (R. 36-37.)

During the taxable years the Foundation had net income amounting to \$38,484.39, and paid out amounts aggregating \$20,124.09, to organizations and institutions exempt from taxation under Section 101 (6) of the Internal Revenue Code. (R. 37.) During the same period the Foundation paid out \$518.68 to organizations not established as exempt under that provision of the Internal Revenue Code. (R. 35-36.)

The Foundation filed returns for the years involved, claiming exemption from taxation in accordance with the provisions of Section 101 (6) of the Internal Revenue Code, which exemption was denied by the Commissioner. (R. 10.) Later it amended its petition for redetermination of the deficiency assessed by the Commissioner to include a claim of exemption under Section 101 (14) of the Code. (R. 23-25.) The Tax Court decided that the Foundation was not exempt from taxation pursuant to the provisions of Section 101 of the Code (R. 37) and the Foundation here seeks review of that action (R. 44-51).

SUMMARY OF ARGUMENT

The statute provides that corporations to be exempt must be organized and operated exclusively for religious, charitable or educational purposes and that no part of its earnings may inure to the benefit of any private individual. The Foundation was not so organized and operated because one of the dominant purposes of the trust under which it was created was the provision made by the trustor for himself and members of his family. There were provisions for the payment of specified sums for religious and educational purposes but no provision that net earnings above those specified should be used for religious, charitable or educational purposes.

Payments were made from net earnings to private persons and for private purposes. These payments were not made from reservations or exceptions against trust property so that none of the rights ever belonged to the Foundation but were charges against its whole income.

Nor is the Foundation exempt under Section 101 (14) of the Internal Revenue Code. It was not organized exclusively to hold title to property and turn over the entire net proceeds to an exempt organization as required by that provision of law. It was not under any legal obligation to turn over any of its funds to any exempt organization and did in fact indiscriminately distribute part of its net earnings to non-exempt organizations and private persons.

ARGUMENT

I

The purposes for which the Foundation existed and the use of its funds denied it exemption under Section 101 (6) of the Internal Revenue Code

Section 101 (6) of the Internal Revenue Code (Appendix, *infra*) under which the Foundation first (R. 10), and apparently principally, claims exemption from taxation provides that religious, charitable or educational corporations, funds or foundations must be "organized * * * exclusively" for those purposes in order to be entitled to exemption and that no part of its net earnings may inure to the benefit of any private individual. We must, therefore, examine into the purpose of the Foundation here, and the use of its earnings, to determine whether it was organized for reasons which bestow exemption upon it and operated accordingly.

The Tax Court in its opinion stated that one of the dominant purposes of the trust was the provision made by the trustor for himself and the members of his family. (R. 39.) It concluded that "since the trust was created for private as well as for public purposes,

all the income of the trust corpus was not to be devoted exclusively to charitable purposes" and that the Foundation had not met the test prescribed in the statute. (R. 42.)

This conclusion is well established by the evidence. It must be borne in mind that the Foundation is the successor, and for that matter, the creature, of the trust indenture made by Levi M. Davenport with La Verne College on May 23, 1939 (R. 84-98), and that it inherited all the obligations of that agreement (R. 33-34). That instrument stated no purposes for which the trust was operated and the articles of incorporation of the Foundation (R. 114-121) state only that it shall act as trustee under "Christian Educational, Charitable, Eleemosynary, and other charitable trusts * * * in accordance with the respective trusts * * *". The trust instrument did, however, specify how net income was to be distributed and the first and opening paragraph under that section specified that \$400 per month was to be paid to the trustor for life. (R. 85.) The third paragraph of that section of the trust instrument specifies that \$100 per month shall be paid to the trustor's brother, and it provides further that his children shall be provided for in the event they come to want. (R. 86.)

These provisions carved out of the net income of the trust a total of \$500 per month for wholly private purposes, and more if the condition of private persons occasioned or warranted it. This amount compares with only \$300 a month for educational purposes in the second paragraph of the same section of the trust instrument and the equivalent of only \$25 a month in

the fourth paragraph. (R. 86.) This demonstrated to the Tax Court the dominant private and family purposes of the trust upon which it denied exemption.

There would seem to be no doubt that the trustor was a religious person and was motivated by religious and charitable considerations in providing for the Department of Philosophy and Religion at La Verne College, but it is highly significant, in view of the detail with which that department was discussed in the trust instrument (R. 87-88), and the qualifications of trustees were detailed (R. 90-91), that the trust instrument carried no other specifications of religious, charitable or educational institutions to which net income was to be distributed except the sum of \$300 per annum to the American Bible Society out of an income producing estate valued at approximately \$270,000 (R. 29). This fact would indicate that religious, charitable or educational considerations were not the exclusive purpose in setting up the trust.

These factors, are not altered by what happened in the operation of the trust. There is no positive evidence that the payments to the trustor and members of his family were waived despite the Foundation's claim to the contrary here. (Br. 25.) Mr. Allard expressed it merely as his opinion that Mr. Davenport had waived the right to the \$400 annuity when he transferred the "First Street property" to the Foundation (R. 55), but he testified he had no conversation with the corporation about it (R. 57) and that he had had no discussion with the brother or children about the matter and obtained no written release of their rights (R. 59). Mr. Steinour, the

treasurer of the Foundation (R. 59), and only other witness who testified concerning the \$400 annuity to Mr. Davenport, stated on direct examination that the earnings of the "First Street property" were in lieu of the annuity, according to his discussion with Mr. Davenport (R. 63), but on cross-examination he also seemed to be expressing opinion as to waiver of the annuity (R. 65). In any event, there was no written instrument waiving the right either of Mr. Davenport or any member of his family to the specified annuities or discretionary amounts, and the liability under the trust instrument remained at all times an outstanding, and apparently enforceable, obligation against the net income from the trust estate. Moreover, the trust instrument provided that the trust was irrevocable and that none of the trust estate could be withdrawn. (R. 96.) The reconveyance was therefore invalid and could have no effect on the provisions of the trust instrument.

In addition to the obligations which were not of a public nature and which meant that net earnings of the Foundation inured to the benefit of private individuals, it was found by the Tax Court that the Foundation made two payments out of its funds which were clearly outside the scope of the claimed exemption. These were the payments to Lucile Weller and to Homer Davenport of \$1,625 for stock surrendered by them to Levi M. Davenport. (R. 36.) There is no evidence to support the Foundation's contention here (Br. 27) that upon dissolution of the company, whose stock he so acquired, he transferred its assets to the Foundation subject to payment for the stock,

and the fact that it was surrendered to him when the dissolution of the company took place earlier indicates that the payment by the Foundation was a payment for him. This was, in any event, therefore, a use of net income for the benefit of a private individual, a situation precluded by Section 101 (6) if exemption is to be obtained.

Moreover, the rather indiscriminate contribution of various sums to various nonexempt organizations, even though small in amount (R. 36), indicates that there was no definite plan or program on the part of the Foundation to foster and support a particular religious, charitable or educational purpose, but rather to use the net income as the trustor, in his individual capacity, desired. This is borne out by the testimony of the secretary of the Foundation that Mr. Davenport, the trustor, directed where the contributions were to be made. (R. 72.) Indirectly, therefore, unallocated net income of the Foundation inured to his, a private individual's benefit and this defeats exemption under Section 101 (6).

It is clear that the Tax Court could reach no other conclusion in this case than that the Foundation was not exempt under Section 101 (6). It has relied in its decision upon *James Sprunt Benevolent Trust v. Commissioner*, 20 B. T. A. 19, and *Scholarship Endowment Foundation v. Nicholas*, 106 F. 2d 552 (C. C. A. 10th), certiorari denied, 308 U. S. 623. These cases are clearly in point.

In the *James Sprunt Benevolent Trust* case, *supra*, the trustee, as in the instant case, set up a trust providing for the payment annually of specified amounts

to certain religious and educational institutions but as the first stated purposes, also as in the instant case, provided for the support and maintenance of male descendants of his parents as ministers of the gospel. He also provided for the private relief of any worthy lineal descendants of his parents and an honorarium for each of the trustees. The honoraria were paid in the taxable year and amounts were paid to the educational institution but no payments were made to or on behalf of the trustor's family. The trust claimed it was exempt from taxes under a provision of the Revenue Act of 1921 identical with Section 101 (6) of the Internal Revenue Code. The Board of Tax Appeals held that the trust was not exempt because it was not organized exclusively for religious, charitable and educational purposes but primarily and principally for the support of members of the trustor's family in the ministry and for the private relief of other members of his family. These benefits were limited to blood relatives of the trustor and that exclusion of the public, the Board held, bars exemption. The parallel between that case and the instant case is apparent and the Tax Court was correct in similarly deciding this case.

The *Scholarship Endowment Foundation* case, *supra*, is almost on all fours with the instant case. There, one Rastall, his wife and one other person in 1932 organized a nonprofit corporation to aid and assist students and others to secure an education. Rastall transferred to the Foundation \$34,000 in stocks and bonds in the same year in consideration for which the Foundation agreed in writing to pay all of the

net income therefrom to the donor during his life and after his death to his wife during her life. In 1934 a new agreement was entered into under which the donor relinquished all rights and interests in and to the securities and in consideration thereof the Foundation agreed to pay him annually during his life the sum of \$5,000 and after his death to pay that amount annually to his wife, during the balance of her life. Rastall made subsequent donations of securities to the Foundation, and in 1936 the value of the donations so made was \$130,000 and in 1937, \$165,000.

No scholarships were awarded in 1932 or 1933 and those in 1934, 1935 and 1936 were \$100, \$200 and \$1,000, respectively. The gross income in 1936, the taxable year involved in that case, was \$15,700, and after making deductions including annuity payments to the donor, the net income was \$10,075. The donor actually drew on account of the annuity during that year only \$2,000. The Foundation claimed it was exempt from taxation under Section 101 (6), but the court denied it was entitled to the exemption. In the course of its opinion the court said (p. 553):

It is plain that the Foundation must meet two requirements in order to come within the ambit of the statute and be entitled to exemption under its provisions. It must be a corporation organized and operated exclusively for educational purposes, and none of its net earnings shall inure to the benefit of any private individual.

The court recognized, without deciding, that under the provisions of the original contract reserving the net income to the donor and his wife, the Foundation merely acted as a conduit for the receipt and transmission of the income and did not fall outside the statute for that reason. It pointed out, however, that the new contract was in force and effect throughout the years in question. Under its provisions the Foundation acquired from the donor the right to receive the income in ownership and in consideration therefor it obligated itself to pay him annually a specified sum during the remainder of his life and thereafter to pay the same amount to his wife during the balance of her life. The obligation was definite and certain in amount and time of payment. The entire assets of the Foundation, both capital and earnings, were unconditionally charged with the obligation and during the period in question payments out of earnings were actually made to the donor on such obligation. It seems clear, the court said, that a part of the earnings thus inured and were devoted to the benefit of a private individual within the intent and meaning of the statute, and that in result the Foundation was not entitled to the exemption for which it contends. That case is authority upon which the decision of the Tax Court in the instant case should be affirmed.

The Foundation in this case pitches its case on the erroneous ground that each of the provisions with respect to the payment of annuities or other amounts, either in the original trust indenture or subsequent agreements, was a reservation and an exception from the properties transferred by the trustor to the Foun-

dation. (Br. 23, *et seq.*) Conceding, as did the court in *Scholarship Endowment Foundation, supra*, that such reservations and exceptions might alter the result in this case, it is clear that there were no such reservations or exceptions here. The only actual reservation was the right, in the original trust indenture, of the trustor to use and occupy the home place rent free for life. (R. 92.) That reservation was vitiated by the subsequent reconveyance of the home place to the trustor (R. 32-33), assuming that, despite the provision of the trust indenture that none of the trust estate might be withdrawn (R. 96), that reconveyance was not invalid. When the home place was conveyed to the Foundation on May 31, 1941 (R. 34), the initial reservation was again reserved but the contemporaneous annuity agreement to pay a stipulated amount to the trustor's daughter and granddaughter was not a reservation against that property. The Foundation received no rent from it (R. 34) and the Tax Court said, as did the Court in the *Scholarship Endowment Foundation* case, *supra*, that the Foundation's obligation to pay these annuities was absolute and not dependent upon whether it had net income or net earnings.

We have pointed out that the situation respecting the "First Street property" was invalid and did not alter the trust agreement. It is also here contended by the Foundation that the additional agreement at the time of the conveyance of this property that the trustor could dispose of the income from the property for a period of ten years after his death by a written document, was in lieu of the right and power of the

trustees, under the original indenture, to provide for the trustor's brother and children in case of want. (Br. 24.) Since at the time of conveyance to the Foundation there was no waiving of rights by trustor's brother and children to part of the income from the trust property (R. 41); no written agreement that those provisions were rescinded and no designation by the trustor of use of income from the property after his death (R. 35), it is clear that those provisions of the trust indenture were not altered and that they contained at all times a direct and complete obligation against the trust income. The transfer of the "First Street property" to the Foundation reasserted the trustor's original intention of procuring an income for life from the trust property for himself and of providing against want and need for members of his family.

It is apparent, we submit, that the Foundation is in error in asserting that all the rights remaining in or going to the trustor and his family were reservations or exceptions from the deeds of property to the Foundation or the predecessor trust, and that as a matter of law none of those rights ever belonged to the Foundation. Its reliance therefore upon *Lederer v. Stockton*, 260 U. S. 3; *Emerit E. Baker, Inc. v. Commissioner*, 40 B. T. A. 555; *Estate of Whitehead v. Commissioner*, 3 T. C. 40, affirmed *sub nom. Commissioner v. Citizens and So. Nat. Bank*, 147 F. 2d 977 (C. C. A. 5th); *Pasadena Methodist Foundation v. Commissioner*, decided October 11, 1943 (1943 P-H T. C. Memorandum Decisions, par. 43,451); *Home Oil Mill v. Willingham*, 68 F. Supp. 525 (N. D. Ala.), and

other authorities cited (Br. 21) is misplaced since in those authorities there was an actual reservation or the right of an organization to acquire trust property fully by discharging an obligation. The Tax Court in its opinion has shown the inapplicability of the rule of the *Stockton* and *Baker* cases, *supra*. (R. 39-41.) None of those cases are authority upon which the decision of the Tax Court may be reversed while the cases of *James Sprunt Benevolent Trust v. Commissioner, supra*, and *Scholarship Endowment Foundation v. Nicholas, supra*, are authorities supporting the Tax Court's decision that the Foundation is not an exempt corporation under Section 101 (6) of the Internal Revenue Code.

II

The Foundation was not organized exclusively to hold title to property, collect income therefrom and turn over the entire amount less expenses to an exempt organization and is therefore not exempt under Section 101 (14) of the Internal Revenue Code

The Foundation contends in the alternative that if it is not exempt from taxation under Section 101 (6) of the Internal Revenue Code it is exempt under Section 101 (14). This section provides that a corporation which is organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof less expenses, to an organization which itself is exempt from tax, is exempt from taxation. The Tax Court held that it was not exempt under this section because, as the record clearly shows, a portion of its income was distributed to organizations or persons not exempt

from tax. That is sufficient to defeat the Foundation's claim since the statutory provision specifies that the entire amount of net income must reach exempt hands, but another point is significant.

The trust does not provide nor indicate that a particular organization, an exempt organization, to use the words of the statute, or particular organizations should receive the entire amount of the net income from the trust property, nor does it actually specify who or what organization or organizations shall receive the net amount over and above specified annuities and grants. The use of the net amount was left to the sole discretion of the trustees (R. 115) and they, under the direction of the trustor and in accordance with his wishes (R. 72), distributed some but not all of it indiscriminately as contributions among several, not only one, exempt organizations (R. 37), and several nonexempt organizations (R. 35), and to private persons (R. 36) and for private purposes (R. 34, 35). Thus it is seen that there was no intention that the Foundation was organized to get net income into the hands of an exempt organization.

In the case of *Banner Building Co. v. Commissioner*, 46 B. T. A. 857, exemption under Section 101 (14) was denied for that reason. The Board, in deciding that case, said (p. 863) that a holding company under that paragraph is one which has been organized for the exclusive purpose of holding title to property, collecting the income therefrom and turning over the entire amount, less expenses, to an exempt association and that the taxpayer had not shown that it was organized for any such purpose. The taxpayer in

that case contended that actual operations rather than corporate form, were the test of its rights to exemption. The Board, while stating that the record in the case did not show compliance in respect to operations, disposed of this position by stating (p. 864) that an essential requirement of a holding company under the paragraph pleaded is that it turn over income from property held, less expenses, to an exempt association and that the taxpayer had not shown it was under any legal obligation to turn over any of its funds to an exempt association nor had it shown that it did in fact pay over any of its funds to such an association. The failure in that essential, the Board held, precludes classification as an exempt corporation under Section 101 (14). In *N. P. E. F. Corp. v. Commissioner*, decided April 29, 1946 (1946 P-H T. C. Memorandum Decisions, par. 46,100), the Tax Court allowed the exemption where that essential was met.

In the instant case the Foundation was under no legal obligation to turn over any of its funds to an exempt organization and the *Banner Building Co.* case, *supra*, supports the decision in this case. The record, in addition to showing that \$20,000 went to various exempt organizations, shows that substantial sums (R. 34, 35, 36) went for nonexempt purposes.

The Foundation here (Br. 34) pleads the doctrine of *de minimis* to avoid the effect of non-exemption to it under Section 101 (14), but in so doing it refers only to amounts contributed to organizations the status of which was not established. Even if those were the only objectionable items, the rule would not aid the Foundation in view of the clear language of the

statute, but it is not only those items which have effect in the decision of this case. It is also those amounts which went to private persons and for private purposes and these, amounting to over \$12,000 in the taxable years, as pointed out above, are too substantial to be helped by the *de minimis* doctrine.

Moreover, the Foundation asserts (Br. 35) that if any unauthorized distribution has been made this will not defeat exemption because it will recoup them against the trustor. Unauthorized distribution might not defeat exemption if it otherwise existed but recoupment here will not aid the Foundation since it is not, as required by the statute, obligated to pay all of its net earnings into exempt hands.

CONCLUSION

The decision of the Tax Court is correct and should be affirmed.

Respectfully submitted.

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APPENDIX

Internal Revenue Code:

SEC. 101. EXEMPTIONS FROM TAX ON CORPORATIONS.

The following organizations shall be exempt from taxation under this chapter—

* * * * *

(6) Corporations, and any community chest, fund, or foundation, organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes, or for the prevention of cruelty to children or animals, no part of the net earnings of which inures to the benefit of any private shareholder or individual, and no substantial part of the activities of which is carrying on propaganda, or otherwise attempting, to influence legislation;

* * * * *

(14) Corporations organized for the exclusive purpose of holding title to property, collecting income therefrom, and turning over the entire amount thereof, less expenses, to an organization which itself is exempt from the tax imposed by this chapter;

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(26 U. S. C. 1946 ed., Sec. 101.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

SEC. 19.101.1. *Proof of exemption.*—A corporation is not exempt merely because it is not organized and operated for profit. * * *

The words “private shareholder or individual” in section 101 refer to individuals having a personal and private interest in the activities of the corporation. * * *

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When an organization has established its right to exemption, it need not thereafter make a return of income or any further showing with respect to its status under the law, unless it changes the character of its organization or operations or the purpose for which it was originally created. * * *

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SEC. 19.101 (6)-1. *Religious, charitable, scientific, literary, and educational organizations and community chests.*—In order to be exempt under section 101 (6), the organization must meet three tests:

(1) It must be organized and operated exclusively for one or more of the specified purposes;

(2) Its net income must not inure in whole or in part to the benefit of private shareholders or individuals; and

(3) It must not by any substantial part of its activities attempt to influence legislation by propaganda or otherwise.

Corporations organized and operated exclusively for charitable purposes comprise, in general, organizations for the relief of the poor. * * *

An educational organization within the meaning of the Internal Revenue Code is one designed primarily for the improvement or development of the capabilities of the individual. * * *

Since a corporation to be exempt under section 101 (6) must be organized and operated exclusively for one or more of the specified purposes, an organization which has certain religious purposes and which also manufactures and sells articles to the public for profit, is not exempt under section 101 (6) even though its property is held in common and its profits do not inure to the benefit of individual members of the organization. * * *

A corporation otherwise exempt under section 101 (6) does not lose its status as an exempt corporation by receiving income such as rent, dividends, and interest from investments, provided such income is devoted exclusively to one or more of the purposes specified in that section.

Sections 29.101-1, 29.101 (6)-1 and 29.101-2 as added by T. D. 5381, 1944 Cum. Bull. 188, of Treasury Regulations 111, promulgated under the Internal Revenue Code, applicable to years beginning after December 31, 1941, are substantially identical with the quoted provisions of Treasury Regulations 103.

